PRICEWATERHOUSECOOPERS

Premera's Executive Compensation Review
Summary of Issues – Resolved or Pending

Report Addendum

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February 27, 2004

Prepared for the Washington Office of the Insurance Commissioner

Overall Conclusions

Overall, the changes Premera has agreed to and filed in the Form A as of February 5, 2004, represent significant and positive progress towards executive compensation programs that are more aligned to the interests of shareholders and address many of the concerns raised by PwC and other members of the Washington and Alaska teams.

- We believe many of the executive compensation issues identified in our reports to the OIC and subsequently directly to Premera related to Premera's Form A, Exhibit G-10 filing, and Equity Incentive Plan have been addressed by Premera and now fall within the range of market standards.
- While Premera has provided "Compensation Assurances", Exhibit E-8, we do believe that certain important issues require further consideration. The following items remain a concern to PwC:
    - Long-Term Incentive Plan (LTIP) design and administration
    - Officer base salary growth
    - Selected Premera change-in-control policy provisions
- While we have discussed these issues with Premera and have assessed their rationale for their position, we believe it is important that the Commissioner understand these particular characteristics of the compensation programs.
- We acknowledge the benefits of oversight of an independent and diligent Compensation Committee, but we also note that there are real limitations to the process. These limitations can be mitigated through plan provisions that provide explicit "checks-and-balances."
- The following discussion of issues raised in the amended Form A Filing represent PwC's perspective on the substantial issues related to the revised Exhibit G-10 filing and Equity Incentive Plan, and may not reflect other issues that a) may have been raised in our discussions with the company and ultimately resolved, b) represent drafting errors and c) do not present significant issues.

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I. Outstanding Issues Raised in Our October 2003 Report to the Washington Office of the Commissioner (the "Original Report")

Issue No.	Issue	Premera's Response	Status
1) Long-Term Incentive ("LTIP") Payout Determination	▪ Long-term incentive payouts are determined based on a participant's salary level at the end of the three-year performance period. ▪ Given that average base salaries for Premera's officers (vice-presidents and higher) have increased by approximately 6 percent per year for the last 5 years (1998-2002), the projected long-term incentive payouts will be higher than the initial award opportunity @ grant by about 20 percent. ▪ This is not consistent with competitive practices and, more importantly, not in compliance with Internal Revenue Code Section 162(m) that governs the deductibility of compensation payable to a company's top five paid executive officers.	▪ No planned changes	▪ *Potential Mitigating Action(s): Long-term incentive payouts (cash or stock) should be based on salary levels in effect at the time of the award/grant and NOT at the time of payout.*
2) Voluntary Turnover	▪ Premera's company-wide for period 1999-2001 and officer voluntary turnover rates for the period 2000-2002 are below industry norms. ▪ This does not support the belief on the part of Premera's Board of Directors that a conversion to a publicly-held company will strengthen retention through the use of equity incentive vehicles such as stock options and other stock-based awards.	▪ Premera believes their officer (i.e., VPs and above) turnover is high compared to industry norms.	▪ *Issue resolved; Board belief is not substantiated by data.*

Issue No.	Issue	Premera's Response	Status
3) Incentive Funding/ Goal Setting	▪ The Long-Term and Annual Incentive Plans provide payouts to participants for achievement of threshold performance goals. ▪ Compared to market practices, the minimum performance goals established by Premera are understated in comparison to historical, actual performance, as well as to budget.	▪ Premera maintains that all decisions governing the design, operation and administration of incentive plans fall within the scope and authority of the Compensation Committee. The Compensation Committee will exercise its fiduciary duty in a rational and thoughtful manner that serves the best interests of shareholders. ▪ Premera will allow the Foundation Shareholder to designate an individual to serve on its Compensation Committee.	▪ *Potential Mitigating Action(s): With respect to the annual incentive plan, establish minimum performance goals that take into account prior years' performance results and management's expectations of next year's performance.* ▪ *With respect to the LTIP, establish a minimum shareholder return before any payment is triggered. This ensures an appropriate pay and performance relationship exists, on behalf of the shareholders and the OIC.*
4) Performance Measures	▪ 40% of the Annual Incentive Plan is determined based on the achievement of non-financial performance measures. ▪ To conform to market practices, a higher proportion of senior executive officers' incentive payouts should be linked to achievement of financial performance measures.	▪ Premera maintains that all decisions governing the design, operation and administration of incentive plans fall within the scope and authority of the Compensation Committee. The Compensation Committee will exercise its fiduciary duty in a rational and thoughtful manner that serves the best interests of shareholders.	▪ *Potential Mitigating Action(s): Premera should de-emphasize the impact of non-financial performance measures in determining annual incentive payouts for SVPs, EVPs and the CEO. A meaningful portion of the annual and long-term incentive payout should be linked to achievement of operating margin goals.*

Issue No.	Issue	Premera's Response	Status
5) Deferred Compensation	▪ Participants receive a 40% match on mandatory deferrals payable over 4 equal annual installments. ▪ A 40% match is high compared to market practices in compensating for the risk of forfeiture with a premium return on the deferral.	▪ Premera's compensation consultant (Mercer) has recommended that mandatory deferral/ match provision be eliminated.	▪ *Issue resolved, assuming Premera implements Mercer's recommendation effective for 2004.*
6) Defined Contribution (DC SERP) and Defined Benefit SERP (DB SERP) Programs	▪ Executives participate in a number of different nonqualified executive retirement plans that are not subject to any benefit or company contribution offsets. ▪ Market practice is to provide calculated benefit offsets on company contribution to participants from other qualified, non-qualified or statutory plans.	▪ Clarifications provided in the October 16 facsimile from Premera (i.e., labeled Exhibit 4).	▪ *Potential Mitigating Action(s): Include a provision in each respective plan such that the aggregate retirement benefit provided by the DC and DB SERP is offset by qualified retirement benefits, company contributions to deferred accounts and Social Security benefits.*
7) Change in Control (CiC) : "Walk-Away Rights"	▪ In the event of a CiC, the CEO, CFO and EVPs can terminate employment for any reason during a 30-day window period following the 1 year anniversary of a CiC event and collect 50% of the original CiC benefits.	▪ Clarifications provided in the October 16 facsimile from Premera (Exhibit 4).	▪ *Potential Mitigating Action(s): To preserve retention, preclude unintended CiC benefits, and conform to market practices, limit "walk-away rights" to the CEO only.*
8) Change in Control: Enhanced DB SERP	▪ In the event of a change in control, the value of the DB SERP takes into account the individual's Final Compensation which includes the value of severance benefits payable.	▪ Clarifications provided in the October 16 facsimile from Premera (Exhibit 4).	▪ *Potential Mitigating Action(s): Exclude severance benefits payable from Final Compensation in determining the enhanced DB SERP benefit.*

II. Outstanding Issues Raised in Our November 2003 Addendum Report to the Washington Office of the Commissioner (the "Addendum Report")

Issue No.	Issue	Premera's Response	Status
1) Long-Term Incentive Plan Continuation	▪ Cash or stock-based long-term incentive plans are not prevalent within Premera's peer group of public companies, and particularly in situations involving IPOs. ▪ Within the 2002 and 2003 peer groups (used by Premera's Compensation Committee), only 3 of 14 companies and 2 of 10 companies respectively, maintained an LTIP. In particular, Anthem (2002) and WellChoice (2003) maintained an LTIP but no stock options were granted to LTIP participants. ▪ These findings are consistent with industry best practices.	▪ Premera believes the LTIP serves an integral role in providing a balanced and diversified mix of long-term incentives to its executives. ▪ In addition, beginning with the 2005-2007 performance period, awards will be delivered in shares which further align the interests of management and shareholders.	▪ *Potential Mitigating Action(s): Given the relatively low Premera LTIP threshold, establish a minimum shareholder return before any LTIP incentive payment is triggered. This ensures an appropriate pay and performance relationship, on behalf of the shareholders and the OIC.*
2) Restriction Period of Stock Grants to Executive Officers and Outside Directors	▪ The length of the restriction period should commence upon the IPO and end 6 – 12 months thereafter.	▪ Premera agreed to a 1 year restriction period	▪ *Issue Resolved.*

Issue No.	Issue	Premera's Response	Status
3) Share Usage	▪ Premera's total share reserve pool can potentially be depleted in a short period of time following the IPO.	▪ Premera has agreed to annual limitations on the aggregate number of options that can be granted. These annual limitations will extend the life of the reserve pool to three years following the IPO.	▪ *Issue Resolved.*
4) Type of Stock Awards	▪ Executive officers of Premera should be prohibited from receiving all types of stock-based compensation during the restriction period including stock options, restricted stock, and stock appreciation rights.	▪ Premera has agreed not to grant any form of stock-based compensation during the restriction period to its executive officers and outside directors.	▪ *Issue Resolved.*
5) Maximum Stock Option Grant to an Individual	▪ The Equity Incentive Plan must state the maximum number of stock options that can be granted to an individual.	▪ Premera has updated the plan to include a maximum number of options that can be granted to a single individual.	▪ *Issue Resolved.*
6) Change in Control: Stock Option Vesting Acceleration	▪ In the event of a change in control, any accelerated vesting of unvested stock options should be prohibited within two years of the conversion.	▪ Premera has agreed to this provision.	▪ *Issue Resolved.*

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III. New Issues Raised During and/or After the Deposition Process ("New Issues")

Issue No.	Issue	Premera's Response	Status
1) Long-Term Incentive Plan Mix	▪ Premera's LTIP incentive opportunity accounts for about one-third of the total LTI opportunity for plan participants, which is greater than what is typically found at Premera's peer companies with both an LTIP and stock option grant. ▪ For example, within the last two peer groups used by Premera's Compensation Committee, LTI represented 8% of the total LTI opportunity for the CEOs in 2002, and 10% in 2003. These findings are again consistent with, though actually slightly lower than, industry market practices.	▪ Premera maintains that all decisions governing the design, operation and administration of incentive plans fall within the scope and authority of the Compensation Committee. The Compensation Committee will exercise its fiduciary duty in a rational and thoughtful manner that serves the best interests of shareholders.	▪ *Potential Mitigating Action(s): Establish a minimum shareholder return before any incentive payment is triggered. This ensures an appropriate pay and performance relationship exists, on behalf of the shareholders and the OIC*
2) Long-Term Incentive Award Opportunities	▪ The post-conversion target long-term incentive opportunities provided to the CEO and EVPs (Top Five) are significantly greater than pre-conversion opportunities. ▪ The proposed target long-term incentive opportunity, excluding the proposed stock option grants, to be provided to Top Five has increased, in aggregate, by 15% (2004) to 30% (2005) from pre-conversion levels. ▪ Post-conversion, in 2005, the value of the total target long-term incentive opportunity (the proposed stock option plus LTIP grants), will have increased by over 300 percent in aggregate to the Top Five as compared to the pre-conversion opportunity.	▪ Premera maintains that all decisions governing the design, operation and administration of incentive plans fall within the scope and authority of the Compensation Committee. The Compensation Committee will exercise its fiduciary duty in a rational and thoughtful manner that serves the best interests of shareholders.	▪ *Potential Mitigating Action(s): Limit salary increases to verifiable market rates of percentage increases to executive salaries.*

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Issue No.	Issue	Premera's Response	Status
3) Officer Base Salary Increase	▪ Base salaries are currently reasonably competitive. ▪ Base salary levels determine the value of Premera's other executive compensation and benefit programs (i.e., determined as a multiple of salary), hence any salary increase compounds the opportunity or benefit received by officers under Premera's various incentive, retirement and CiC programs.	▪ Premera maintains that all decisions governing the design, operation and administration of incentive plans fall within the scope and authority of the Compensation Committee. The Compensation Committee will exercise its fiduciary duty in a rational and thoughtful manner that serves the best interests of shareholders.	▪ *Potential Mitigating Action(s): Limit officer base salary increases to verifiable market rates (typically 4%-5%).*
4) Peer Group Composition	▪ Premera's proxy peer group is not appropriate. ▪ The size of several companies within Premera's current peer group (as summarized in Mercer's February 2003 report to the Compensation Committee) is five times Premera's revenues for 2001. We can note that market cash compensation levels are directly linked to company revenue, and market LTI levels are similarly highly correlated to company market capitalization.	▪ Premera has prepared a "compensation assurances" statement ensuring that that its Compensation Committee will select companies that are (i) comparable in size (i.e., no greater than two-times the annual revenue) and (ii) within the same SIC code. In addition, Premera has agreed to replace/substitute peer companies from a "pre-approved" list of companies that include: Amerigroup Corporation First Health Group Corporation Health Management Associates Triad Hospitals, Inc. Universal Health Centene	▪ *PwC's concern is mitigated.*

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Issue No.	Issue	Premera's Response	Status
5) Governance of Executive Compensation Matters	▪ PwC wants to ensure that the Foundation Shareholder has a voice and vote on executive compensation matters.	▪ Premera will allow the Foundation Shareholder to designate an individual to serve on its Compensation Committee.	▪ *PwC's concern is mitigated.*